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SUBJECT: South Africa: Minerals and Energy Newsletter "THE ASSAY" - Issue 7, July 2009

This cable is not for Internet distribution.

¶1. (SBU) Introduction: The purpose of this newsletter, initiated in January 2004, is to highlight minerals and energy developments in South Africa. This includes trade and investment as well as supply. South Africa hosts world-class deposits of gold, diamonds, platinum group metals, chromium, zinc, titanium, vanadium, iron, manganese, antimony, vermiculite, zircon, alumino-silicates, fluorspar and phosphate rock, and is a major exporter of steam coal. South Africa is also a leading producer and exporter of ferroalloys of chromium, vanadium, and manganese. The information contained in the newsletters is based on public sources and does not reflect the views of the United States Government. End introduction.

¶2. (SBU) CONTENTS:

HOT NEWS

Energy Projects on Hold

¶3. (SBU) State-owned power utility Eskom has put five projects, worth some $7 billion and 2,900 megawatts, on hold as a result of a funding shortfall. Media reports raise the threat of future power shortages and quote a Frost & Sullivan energy analyst, saying the project halts would reduce Eskom's spending, deepen South Africa's recession, cut opportunities in employment creation, and affect suppliers of cement, steel and other commodities. The reduction in spending is aimed at helping Eskom focus on its three priority projects, namely, two coal thermal stations, Medupi and Kusile, and a pump-storage station, Ingula, which together will cost about $30 billion and produce 10,900 megawatts of power. Dropped from the current spend are a 1,500 megawatt pump-storage project, a 100 megawatt solar plant, a 100 megawatt wind farm, CIC Energy's 1,200 megawatt Mmamabula coal thermal project in Botswana, and an 80-kilometer rail link to the Majuba thermal station. According to Eskom figures, the respective build costs per megawatt for the coal thermal, pump-storage, solar and wind stations are: $2.6-$3.1 million; $1.6 million; $2.5-$7.5 million; and $3.75 million.

SA-Zimbabwe Investment Security Deal

¶4. (SBU) The long-awaited Bilateral Investment Protection Agreement (BIPA) between Zimbabwe and South Africa may soon be concluded. The agreement has remained in limbo since 2004, while the Zimbabwean
Qagreement has remained in limbo since 2004, while the Zimbabwean

government unilaterally took over land, mine, and business assets of local and foreign investors, including those of South African nationals. Zimbabwe's Finance Minister Tendai Biti said negotiations should be concluded soon. South Africans interested in investing in Zimbabwe have insisted that a BIPA be signed before they invest. Details of the treaty are still being negotiated.

Coal, Gold, and Power Settle

¶5. (SBU) South African labor unions signed a two-year wage agreement with the Chamber of Mines at the end of July, thus avoiding costly strikes. The agreement covers the coal and gold mining sectors. In general, higher wage earners such as miners, artisans, and officials will receive a 9% increase for the first year of the agreement, while lower paid employees will receive a 10% increase. Salaries and "living out" allowances for entry level employees will be increased by 11%. In the second year of the wage agreements, an average of consumer price inflation plus one percent -- at a minimum of 7.5 percent -- was agreed for both sectors.

¶6. (SBU) The Chamber's coal negotiator Frans Barker said he was pleased with the outcome, as employers and unions had approached the negotiations in a constructive manner. This was the first time wage negotiations had been concluded without referral to the Council for Conciliation, Mediation, and Arbitration (CCMA). The two-year agreements will reduce the likelihood of strikes during the 2010 soccer world cup competition. State-owned power utility Eskom, in turn, reached a settlement with its unions on May 13. Unions initially demanded a 14% increase, but finally accepted Eskom's offer of 10.5% and agreement to review housing allowances.

Strikes - Investors Shaken but not Deterred

¶7. (SBU) Labor union rhetoric, a few strikes and the odd unruly protest in South Africa had foreign investors worried, but so far the disputes and wage deals are in line with previous years and economic output has not been affected. The state-owned Industrial Development Corporation's (IDC) head of mining economics Abel

Malinga said mine output had not been affected by strikes and there was no real indication of a major swing towards a labor-based policy by the new government. Andrew Levy's labor analyst, Jackie Kelly, said once the wage negotiation round is over there will again be industrial peace.

Westcor to Drop DRC Inga 3 Hydro Project

¶8. (SBU) Western Power Corridor Company (Westcor) CEO Pat Naidoo said the consortium plans to withdraw from the Inga 3 5,000 megawatt hydro-electric power project on the Congo River in the Democratic Republic of the Congo (DRC). Westcor attributed its decision to withdraw on the mounting political risk in the country and the DRC Qwithdraw on the mounting political risk in the country and the DRC government's decision to go it alone on the project, in partnership with BHP-Billiton, the world's biggest mining company. BHP is planning to build a $3 billion, 800,000 ton per year aluminum smelter in the DRC. Inga 3 and Grand Inga, the proposed giant hydro plant close to Inga 3 that has been on the table for the past decade and more, would have a combined estimated capacity of some 100 gigawatts and are seen by many as the long-term solution to Africa's power problems.

¶9. (SBU) To date, investors have held back due to political risk and the estimated $5 to $7 billion cost of the Inga 3 project. Naidoo said he would recommend to the Westcor Board not to proceed with the project and instead to look at developing smaller projects in Angola and Namibia, even though the joint venture between five Southern African utilities had completed the pre-feasibility study. He noted

that about 3,000 megawatts of Inga 3 power would have gone to South Africa and 1,000 megawatts each to the DRC and other project members. Westcor was established in 2003 as a joint venture between utilities of the DRC, South Africa, Namibia, Angola, and Botswana to study the power-generating potential of the Congo River and other hydro projects in the region. Doubts have been expressed by Westcor as to BHP-Billiton's willingness to pay the full cost of the project.

ENERGY

Airport Jet Fuel Shortage

¶10. (SBU) Media reports portrayed the jet fuel shortage at Africa's largest airport, OR Tambo International in Johannesburg, as posing a threat to tourism and eventually to the 2010 soccer world cup event. Jet fuel stocks were at one stage purported to hold two days of supply, while the internationally accepted norm is five-and-a-half days. Energy Minister Dipuo Peters met with key players in the liquid fuels industry to ensure that the current shortages do not reoccur and that adequate fuel will be available during the 2010 soccer competition. She established a task team to investigate the problem and the airport asked airlines to temporarily cut back fuel usage by 30%. At no time have flights been delayed due to the lack of jet fuel.

¶11. (SBU) The jointly owned Sasol/Total's Natref Refinery at Sasolburg provides 70% of the airport's jet fuel and the balance is moved by Transnet Freight Rail (TFR) from coastal refineries in bulk rail tankers. Fuel shortages appear to have been caused by a combination of temporary shutdowns of refinery and pipeline capacity and a disruption to rail shipments. Reports indicate that all facilities are again running normally. The supply of liquid fuels to the interior has been identified as a potential vulnerability and private suppliers have increased road tanker traffic in response.

SAG Supports Nuclear Development

¶12. (SBU) The SAG remains committed to conventional nuclear energy and to the development of South Africa's pebble-bed modular reactor (PBMR) program, according to Public Enterprises Minister Barbara Hogan. The PBMR is a fourth generation, high temperature, helium gas-cooled nuclear reactor. In her address to delegates at the PBMR workshop in Johannesburg on localization opportunities in the uranium industry, she said the SAG's priorities for economic development were skills development and product "localization" to increase the percentage of locally manufacture products using local skills and labor. Further, according to Hogan, the redesigned PBMR would boost the economy through job creation and its ability to provide electricity, process heat, steam, and hydrogen. Hogan pointed out that the PBMR company represented the largest cluster of nuclear engineering and design skills in Africa, which is a
Qnuclear engineering and design skills in Africa, which is a prerequisite for establishing South Africa as a center of nuclear expertise and component manufacturing. She identified likely applications for the PBMR's process steam and heat as being seawater desalination; mobilization of heavy oils; recovery of oil from tar sands, oil shales, and coal; and high temperature production of hydrogen.

¶13. (SBU) PBMR's CEO Jaco Kriek said, at the same workshop, that cost and budget overruns were mainly due to the repositioning of the PBMR in terms of market opportunities. Instead of using super-heated helium to directly drive gas turbines, the new design will transfer heat from the helium to generate steam, which will

indirectly drive the turbines and deliver process heat and steam. This will also enhance safety, because the radioactive helium will be in a closed circuit with the reactor pebbles and have no contact with the steam. PBMR has signed a MOU of cooperation with the Chinese, who are also developing PBMR-type technology and have had a 10 megawatt research unit in operation since 2003. Kriek said the planned demonstration PBMR reactor will generate 200 megawatts of heat and 80 megawatts of electricity and is expected to start operating by 2018. Eskom and the Industrial Development Corporation (IDC) hold an 85% stake in PBMR and the remainder is held by U.S.-based Westinghouse. The plant has yet to receive environmental clearance, which has previously held up construction.

Uganda Finds More Oil

¶14. (SBU) British Tullow Oil has announced the discovery of a small new oil field in Uganda, which is estimated to hold up to 50 million barrels of crude. The Uganda site is located in the Victoria Nile Delta, off the northeastern shore of Lake Albert. The discovery would add to the 700 million confirmed barrels in Tullow's Ngara-1 block, which surrounds the northern tip of Lake Albert and borders the Democratic Republic of Congo (DRC). Tullow has drilled 10 wells on the site and industry analysts believe total reserves in the field could reach 2 billion barrels. Tullow also has a 70% stake in the Kudu gasfield off the coast of Namibia.

Malawi, the New Uranium Producer

¶15. (SBU) The $200 million Kayelekera uranium mine in northern Malawi started production in April 2009 and is expected to produce about 3.3 million pounds of uranium oxide per year. This will make uranium the country's top foreign currency earner in coming years, said Malawi President Bingu Wa Mutharika at the official launch of the mine. Malawi is expected to earn over $100 million per year in export earnings, royalties, and taxes and provide 300 direct and 1,000 indirect jobs. The mine will add about 10% to Malawi's GDP of $2.2 billion over an estimated 12-year life. The orebody is a high-grade sandstone replacement deposit, and the mine is 85% owned by Australia's Paladin Uranium and 15% by the government of Malawi. Langer Heinrich in Namibia is Paladin's other uranium mine in

Africa.

Power Boost for Southern African Region

¶16. (SBU) Four Southern African countries have agreed to develop a $225-million power line that would allow an extra 600 megawatts to be transmitted around the region. Zimbabwe, Zambia, Botswana and Namibia have signed a memorandum of understanding (MOU) to develop an electricity transmission interconnector that will facilitate power trading among the participating utilities, collectively known as Zizabona, via the Southern African Power Pool (SAPP). The
Qas Zizabona, via the Southern African Power Pool (SAPP). The
Zizabona project will provide an alternative transmission route to help decongest the existing central transmission corridor to South Africa, which is battling to meet local and regional demand. It will also facilitate transmission of hydropower from the Democratic Republic of Congo (DRC) to South Africa and the rest of the region. Zizabona will finance the project.

¶17. (SBU) Apart from the Zizabona link, Zimbabwe's power utility ZESA has proposed the construction of a 160 kilometer Central Transmission Corridor (CTC) to increase the north-south power transfer capacity to South Africa to 600 megawatts, compared to the current 200 megawatts. This project will be jointly developed by ZESA, with a 20% share and the private investors with 80%. ZESA said the project will cost $100 million and CTC had reached a long-term off-take agreement with South Africa's power utility

Eskom. CTC expects the project to be completed by December 2012.

MINING

All Eyes on Xstrata and Anglo

¶18. (SBU) The global mining industry is watching CEO Mick Davis for an update on Xstrata's proposed "merger of equals" with Anglo American. The interest is whether Xstrata will provide a "sweetener" to its proposed $68 billion deal, which would create a rival to the larger players such as BHP-Billiton, Rio Tinto, and Vale. Despite Xstrata's 77% decline in first-half year profits, announced at the beginning of August, there is speculation that Xstrata is preparing a $5 billion rights issue that will provide a cash sweetener for a renewed bid for Anglo. Anglo's shareholders have so far backed their board's refusal to accept the merger, arguing that a deal would require a premium to be paid. Industry analysts believe that if Xstrata does not launch a bid soon, Anglo may invoke the ''put up or shut up'' rule, which would force Xstrata to make a formal bid within a defined period or walk away for at least a year. Xstrata so far shows no signs of giving up its quest for Anglo, which has long been Davis' takeover target.

Job Losses as Platinum Projects put on Hold

¶19. (SBU) Some $5.5 billion worth of capital projects are on hold across South Africa's platinum sector. The world's biggest platinum producer, Anglo Platinum (Angloplats), has been forced to defer five projects, valued at $4 billion, by between one and four years due to the economic crisis and the company's poor financial performance. The group reported a 95% fall in operating earnings during the first half of the year compared to the previous period, with five of its 18 operations registering operating losses. Angloplats has attributed these poor results to the 51% fall in the dollar price of the basket of platinum group metals (PGM - platinum, palladium, rhodium and other minor metals) sold. There is no estimate of job losses, but the capital investment postponements mean that thousands of jobs will not be created and platinum metal exports worth billions of dollars will not take place over the next few years.

¶20. (SBU) Angloplats chief executive Neville Nicolau said the company had shed nearly 12,000 jobs since September 2008, and expected another 1,100 jobs to be cut by the end of the year. However, Angloplats is continuing to develop six projects to the value of $1.225 billion and is expected to maintain capital expenditure at about $1.25 billion a year for the foreseeable future. South Africa's second biggest platinum producer, Impala Platinum, has halted capital expenditures worth $725 million and new entrant Wesizwe, has curtailed work on its $712-million platinum mine.

Are diamonds still a girl's best friend?
QAre diamonds still a girl's best friend?

¶21. (SBU) Half-year profits plunged 99%, from $316 million to $3 million, for the world's top diamond miner, De Beers. Polished diamond sales have experienced the fastest decline since 1974, and rough diamond sales are down by 57%, as a consequence of the recession in markets in the U.S., Europe, and Japan. Prices for rough stones fell by 50% between October 2008 and mid-March 2009, but have since regained some ground. De Beers slashed its production levels over this period by 73%, to 6.6 million carats, and anticipates carat production for the full year to be half that of 2008. De Beers has retrenched 23% (4,700 people) from its global workforce, which includes some 1,415 jobs, or 40% of its South

African workforce of 3,500. The company closed much of its production in Botswana, Namibia, South Africa, and Canada during the first half of this year, but limited production has since resumed at some mines. Diamond sales will exceed new supply for many years, according to De Beers, based on the premise that no major new diamond discoveries have been made in more than a decade, worldwide mine reserves are at an all-time low, and demand is growing from emerging markets.

Namibia Rates High for Mineral Investment

¶22. (SBU) Namibia is already one of the top four uranium producers in the world. This rating received a further boost when exploration company West Australian Metals acquired 80% of the Marenica uranium project. Marenica has an inferred resource of about 34 million pounds of uranium oxide and is located north of Areva's Trekkopje uranium mine in the Erongo Region. Production is expected to begin in 2012. CEO John Young attributes the company's interest in Namibian uranium to the country's stable regulatory and political environment and high prospects for further discoveries.

Zimbabwe Mining Investment Reality

¶23. (SBU) Zimbabwe is planning investor-friendly legislation, according to Mines and Mining Development Minister Obert Mpofu. He was speaking at an OMEGA investment group conference in Johannesburg on August 5, organized to review mining investment opportunities in Zimbabwe since the formation of the country's coalition government of national unity in February 2009. He said the GOZ was reviewing the Indigenization Bill, which in its present form would force foreign companies to sell 51% of their mine assets to Zimbabweans. A number of speakers from the Zimbabwean government, mining industry, and investment houses provided insight into potential developments and remaining concerns in the country. While the consensus view was that little had changed in Zimbabwe mining since February, much was made of hopes for the future in a country that has great mineral potential.

¶24. (SBU) Both positives and negatives for Zimbabwean mining were aired at the conference:
POSITIVES:
-- a legacy of skilled labor force and good infrastructure;

-- favorable geology for platinum diamonds, gold, coal, nickel, and industrial minerals;
-- gold production could reach 50 tons a year by 2015 from 3.5 tons in 2008;
-- platinum output could reach 1 million ounces a year in 15 years, from 170,000 ounces in 2008;
-- two operating platinum mines, one developing mine, and five exploration projects;
-- legal diamonds could earn the country an estimated $600 million a year;
-- mines are able to sell output directly to the market;
-- mines no longer have to surrender part of their foreign
Q -- mines no longer have to surrender part of their foreign
currency earnings to the Reserve Bank;
-- the inflation rate is down to single digits;
-- the local currency has been scrapped in favor of a multi-currency monitory system

NEGATIVES:
-- maintenance/development of labor force skills and infrastructure has been at a standstill;
-- no guarantee of security of tenure;
- pending indigenization legislation (black economic empowerment) has upset investors;
-- possible suspension from global diamond trading;
-- plans to review mining contracts and introduce a "use it or lose it" policy.

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China and Russia Scramble for African Resources
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¶25. (SBU) China has overtaken the United States as Africa's top trading partner, according to a report in South Africa's weekly Engineering News publication. While U.S. trade with sub-Saharan Africa increased by 28% to a value of $104 billion in 2008, the increase was mainly due to high oil prices, which accounted for more than 80% of imports from Africa. By contrast, trade with China in 2008 amounted to $107 billion and has grown tenfold over the past decade. Frontier Advisory's regional investment consultant Martyn Davies argues that the economic crisis is accelerating the geo-economic shift of Africa towards Asia, centered largely on China.

¶26. (SBU) Chinese companies have strong interest in Africa's mineral wealth, estimated at a third of the world's mineral resources. The Zonghui Mining Group signed a $3.6 billion copper agreement with Zambia in July, and the Industrial and Commercial Bank of China (ICBC) is working on some 60 deals with South Africa's Standard Bank, a number in the mining sector, in which it bought a 20% stake for $5.6-billion in 2008. In another example of outside competition for resources, Russian President Dmitry Medvedev visited Egypt, Namibia, Angola and Nigeria in June to secure oil and uranium rights.
GIPS